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POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Statutory Review of the System
for Regulating Rates and Classes
for Market Dominant Products

Docket No. RM2017-3

COMMENTS OF THE PUBLIC REPRESENTATIVE ON
REVISED NOTICE OF PROPOSED RULEMAKING

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I. INTRODUCTION

On December 5, 2019, the Commission issued a revised notice of proposed rulemaking to consider changes to the regulatory system governing market dominant products.¹ That regulatory system was adopted by the Postal Accountability and Enhancement Act (PAEA). The RNOPR is the third notice in a series of proposed rulemakings that began on December 20, 2016.² The Public Representative filed comments in response to each of the prior notices together with the declarations of Dr. John Kwoka, Dr. Robert Wilson, Dr. Timothy Brennan, and Dr. Lyudmila Bzhilyanskaya.³

The December 5, 2019 RNOPR, like the December 1, 2017 NOPR, grows out of the Commission's finding that the existing system for the regulation of market dominant products "as a whole has not achieved the objectives of the PAEA."⁴ The RNOPR makes significant improvements to the proposals presented in the NOPR. However, as discussed in the comments that follow, further improvements are needed.

¹ Order No. 5337, Revised Notice of Proposed Rulemaking, December 5, 2019 (Order No. 5337 or RNOPR). In its notice, the Commission designated the undersigned to serve as Public Representative. Order No. 5337 at 277.

² The first notice was an advance notice of proposed rulemaking issued in this docket on December 20, 2016. Order No. 3673, Advance Notice of Proposed Rulemaking on the Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products. The second notice of proposed rulemaking in this docket was issued on December 1, 2017. Order No. 4258, Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products (NOPR).

³ Comments of the Public Representative, March 20, 2017; Initial Comments of the Public Representative, March 1, 2018 (PR Initial Comments); and Reply Comments of the Public Representative, March 30, 2018 (PR Reply Comments). Attached to these comments is Appendix A containing a list of the Public Representative's prior comments and the corresponding declarations filed with those comments.

⁴ Order on the Findings and Determination of the 39 U.S.C. § 3622 Review, December 1, 2017, at 275 (Order No. 4257).

II. BACKGROUND

In its prior comments in this proceeding, the Public Representative supported continued implementation of the PAEA price cap on market dominant products but recommended a number of modifications to the price cap in order to provide the Postal Service with expanded opportunities to address its deteriorating financial situation. The Public Representative's proposed modifications were:

- Adjustments to the price cap that would respond to continuing declines in mail volume. PR Initial Comments at 55-5.
- Adjustments to the price cap that would give the Postal Service the opportunity to recover retirement obligation costs that are outside its control. *Id.* at 43-55.
- Adjustments to the price cap that would give it the opportunity to reduce, and hopefully, eliminate losses from non-compensatory products and mail classes. *Id.* at 57-61.

In addition, the Public Representative advocated a further review of the market dominant pricing system in three years from the date changes to the current system are implemented.

III. OVERVIEW OF THE COMMISSION'S REVISED PROPOSALS

In its RNOPR, the Commission has proposed the following changes to its earlier proposals:

- Supplemental Rate Authority. The Commission proposes revisions to its proposed supplemental rate authority mechanism to address two underlying drivers of the Postal Service's net losses that are largely outside of its control. These two drivers are declining mail density and statutorily mandated amortization of certain actuarially determined retirement costs.
- Performance-Based Rate Authority. The Commission proposes modification of how operational efficiency and service standards will be measured to determine whether the Postal Service will be eligible to receive one percent of performance-based rate authority.

- Non-Compensatory Products and Classes. The Commission does not propose any substantive changes to its previous proposal for non-compensatory products within a compensatory class of products. The Commission proposes to make the additional 2 percentage points of rate authority for non-compensatory classes optional at the Postal Service's discretion. The proposed requirement that determinations of whether products and classes are non-compensatory be made in an Annual Compliance Determination proceeding is removed.
- Workshare Discounts. The Commission proposes revised rules for worksharing discounts.
- Cost Reduction Reporting Requirements. The Commission proposes new reporting requirements for costs and cost-reduction initiatives.
- Procedural Improvements. The Commission proposes additional procedural rules related to planning rate adjustments of general applicability.
- 5-Year Review. The Commission proposes to begin its next review of the market dominant rate system in five years.

IV. EXECUTIVE SUMMARY

These comments address some, but not all, of the Commission's proposals. In the sections that follow, the Public Representative takes the following positions:

- The Public Representative supports the Commission's proposal to provide the Postal Service with supplemental rate authority based upon exogenous factors.
- The Public Representative supports the Commission's effort to address the adverse effects that declines in mail density have on the Postal Service's ability to achieve net income. The Public Representative presents a detailed analysis of the Commission's Density Rate Authority mechanism and suggests measures to eliminate potential problems.
- The Public Representative supports the Commission's proposal to adjust the price cap to provide the Postal Service opportunities to generate additional revenue for statutorily mandated payments for certain retirement obligations.
- The Public Representative opposes the allocation of a revenue-based allocation of a portion of the cost of these retirement obligations to Competitive products. If an allocation to Competitive products is required,

the Public Representative submits that it should be no more than the minimum contribution percentage requirement established by 39 CFR § 3015.7 (c)(1).

- The Public Representative supports modifications to the mechanism for making price cap adjustments for statutorily mandated payments for retirement obligations. The proposed modifications would provide for earlier commencement of revenue collection and for a shorter, 4-year, phase-in period.
- The Public Representative opposes various requirements that would be imposed on the Postal Service's use of the retirement obligation adjustment including forfeiture of that adjustment, as well as the prohibition on the banking of unused supplemental rate authority.
- The Public Representative continues to oppose the proposed Performance-Based Adjustment. The Commission has failed to address issues previously identified in previous comments filed in response to the NOPR.
- The Public Representative accepts the Commission's proposal to require a minimum rate increase of 2 percentage points for non-compensatory products that are in a compensatory class.
- The Public Representative continues to oppose the Commission's proposal to give the Postal Service an additional 2 percentage points of rate authority for non-compensatory classes. Instead, the Public Representative supports a one-time price cap reset of the price cap that would permit the collection of rates closer to estimated costs.
- The Public Representative submits that the 5-year review period proposed by the Commission is too long and that a 3-year period review period should be adopted.
- The Public Representative also identifies a number of corrections to the language of the proposed regulations.

V. COMMISSION'S SUPPLEMENTAL RATE AUTHORITY PROPOSAL

The Commission's prior supplemental rate authority proposal would have allowed up to 2 percent annually of additional price cap authority over and above CPI-U price cap adjustments for a period of five years after which the additional allowance would have been terminated. NOPR, Attachment A at 22 (proposed § 3010.160). In the RNOPR, the Commission agrees with commenters that its prior supplemental rate

authority proposal “does not adequately respond to ongoing changes that drive the Postal Service’s inability to achieve net income.” RNOPR at 62.

The proposed supplemental rate authority now being proposed would “target [] two underlying drivers of the Postal Service’s net losses that are largely outside of its direct control....” *Id.* The two drivers selected by the Commission are the increase in per-unit cost resulting from the decline in mail density and the statutorily mandated amortization payments for particular retirement costs. *Id.*

A. The Commission Has Properly Based Supplemental Rate Authority on Exogenous Factors

The Public Representative supports the Commission’s decision to base its supplemental rate authority on drivers of the Postal Service’s net losses that are outside of its control. In price cap parlance, drivers of Postal Service losses that are beyond the Postal Service’s control are referred to as “exogenous factors.” In his comments on the Commission’s earlier NOPR, the Public Representative advocated price cap adjustments to account for the exogenous factors of declining demand and statutorily imposed retirement benefits. PR Initial Comments at 43-55.

The Public Representative’s comments were supported by the Declarations of Dr. John Kwoka, Dr. Robert Wilson,⁵ and Dr. William J. Brennan.⁶ As they explained, because these exogenous factors are outside the Postal Service’s control, the costs they impose on the Postal Service are, under established price cap theory, properly reflected in adjustments to the price cap. *See, e.g., Kwoka/Wilson Decl.* at 7-10. As discussed in the sections that follow, the record in this proceeding supports exogenous factor adjustments to the price cap that respond to continuing declines in mail density as

⁵ Declaration of John Kwoka and Robert Wilson, March 1, 2018 (Kwoka/Wilson Decl.).

⁶ Supplemental Declaration of Timothy J. Brennan, March 1, 2018 (Brennan Supp. Decl.).

well as statutorily mandated payments for retirement obligations that are outside the Postal Service's control.

B. The Mechanism Proposed by the Commission to Adjust the Price Cap for Declines in Density Requires Clarification and Further Adjustment

1. Overview

In the Revised Notice of Proposed Rulemaking (RNOPR), the Commission proposes an additional supplemental rate authority, Density Rate Authority (DRA), which was not part of the Commission's proposals put forward at the earlier stages of the 10-year review. The Commission explains that the purpose of the DRA is to provide the dynamic "mechanism to address density declines," where density is defined as volume per delivery point. RNOPR at 12, 64. The Commission maintains that the net losses that result from "the decline in mail density...are largely outside of its direct control [but] create primary obstacles to the Postal Service's ability to achieve net income." *Id.* at 62. The Commission states that the number of delivery points the Postal Service must service and the volume of mail it delivers are also out of the direct control of the Postal Service. *Id.* at 64.

The Commission proposes to modify the price cap to include an additional rate adjustment authority on Market Dominant products, which should be "approximately equal to the density-driven portion of the increase in average cost per piece." *Id.* at 62. The DRA will be calculated annually using a mathematical formula. *Id.*

In this formula, the Commission proposes to multiply two components: the ratio between the institutional cost and the total cost (the institutional cost ratio) for the most recently completed fiscal year and the percentage change in density from the prior fiscal year to the most recently completed fiscal year. *Id.* at 71-72; Attachment A at 25. When the Commission calculates the change in density, it compares the change in density for Market Dominant mail only with the change in density for all of the Postal

Service's mail and chooses the smaller percentage for its calculations of the DRA. *Id.* at 72-73. The Commission asserts that this ensures market dominant products do not subsidize Competitive products. *Id.* at 72-74. Finally, to obtain the DRA, the Commission multiplies the product of two components (the institutional cost ratio and the change in density) by (-1). *Id.* at 72.

For data required to calculate the DRA, the Commission suggests a mix of the Postal Service's existing annual data sources. The Commission proposes to use the Revenue, Pieces, and Weight (RPW) report for volume data, the Cost and Revenue Analysis (CRA) report for cost data, and tables on total productivity factor (TFP) for the number of delivery points. *Id.* at 78. The RPW and CRA reports are part of the Annual Compliance Report (ACR) filings, and the TFP tables represent a separate annual filing.

2. Background

The Commission claims that both the Postal Service and the Public Representative "identified declines in mail density as a driver in net losses," and NPPC discussed "the effect of density on the Postal Service's finances." RNOPR at 63-64. These claims, however, are not quite accurate.

The Postal Service, in its comments on the NOPR, discussed the change in the economies of density and its three compound factors – declining demand, expanding delivery network, and a change in the mail mix.⁷ Therefore, the Postal Service separately discussed two factors that define density: "steep mail volume declines" and "consistent increase in the number of delivery points per year." *Id.* at 71. In addition, the Postal Service discussed "a shift in the mail mix away from higher-contribution mailpieces (like First Class Mail)." *Id.*

⁷ See Initial Comments of the United States Postal Service in Response to Order No. 4258, March 1, 2018 at 71-74 (Postal Service Initial Comments to NOPR).

The Public Representative and declarants Dr. Kwoka, Dr. Wilson, and Dr. Brennan discussed the declining demand and potential remedies, but none of them talked specifically about density. See Kwoka/Wilson Decl. and Brennan Supp. Decl. The declarants defined the demand as mail volume measured in mail pieces, while density, as defined by the Commission, is the number of mail pieces divided by the number of delivery points.⁸ It appears that volume is just one component of density. It would be correct to identify a decline in density with a decline in volume only if the decline in mail volume pieces followed the same trend as decline in density. The analysis of the mail volume and density data performed by Christensen Associates shows that this is not quite true.⁹

Both the Postal Service and the Public Representative proposed certain adjustments to the price cap to account for either changes in economies of density (in the Postal Service's proposal) or mail volume declines (in the Public Representative's proposal). RNOPR at 63-64.

Dr. Brennan for the Public Representative proposed a price-cap adjustment for each class of mail to account for falling demand. This price adjustment was calculated using the following formula:¹⁰

$$\% \Delta V_{[T-1,T]} * \frac{\frac{C_T}{R_T}}{1 - |E_D| * \frac{C_T}{R_T}}$$

Where

⁸ Brennan Supp. Decl. at 3-5, 8-10; Appendix A at 14; Kwoka/Wilson Decl. at 4-5, 17.

⁹ See Comments of the United States Postal Service, March 20, 2017, Appendix E, Christensen Associates, Analysis of the PAEA's CPI-Based Price Cap System and Options for Future Postal Regulation at 8.

¹⁰ See PR Initial Comments at 55-57; Brennan Supp. Decl. at 2-7; Appendix B at 15.

$\% \Delta V_{[T-1,T]}$ is the percent change in mail volume for a particular class of mail from year $T-1$ to year T .

C_T and R_T are the Postal Service's contribution to institutional costs and revenue, respectively, in the year T .

$|E_D|$ is the absolute value of the elasticity of demand.

The data sources for variables included in the proposed formula are the ACR filings (for volume, contribution and revenue data) and the Postal Service's annual demand model (for elasticity of demand data). Brennan Supp. Decl. at 7 n.17.

The Postal Service proposal included an adjustment to the CPI-based authority to account for changes to economies of density. Postal Service Initial Comments to NOPR at 71-74. The proposed additional rate authority was calculated using the following formula:

$$\frac{IC_T}{TC_T} * (\% \Delta RWV_{[T-1,T]} - \% \Delta DP_{[T-1,T]})$$

Where

IC_T and TC_T are the Postal Service's institutional costs and total costs, respectively, in the year T .

$\% \Delta RWV_{[T-1,T]}$ is the percent change in revenue-weighted volume calculated as the sum (by all market dominant mail products) of each product's share of the market dominant revenue (in year T) multiplied by the absolute change in the product's volume (from year $T-1$ to year T).

$\% \Delta DP_{[T-1,T]}$ is the percent change in the number of delivery points (from year $T-1$ to year T).

If from year $T-1$ to year T the revenue-weighted volume decreases and the number of delivery points increases, both variables included in the formula contribute to the proposed adjustment and therefore increase the additional rate authority. *Id.* at 73-74.

By applying the revenue-weighted volume, the Postal Service attempted to account not only for changes in mail volume overall, but also for changes in mail volume mix. *Id.* at 73. As possible publicly available data sources for variables included in the proposed formula, the Postal Service noted the ACR filings (for volume, revenue and cost data) and the annual TFP tables (for the number of delivery points). *Id.* at 73 n.182.

3. Analysis of the proposed DRA

The Public Representative applauds the Commission for introducing the DRA to address the declining demand and some other factors related to changes in the economies of density. The Public Representative agrees with the Commission that the implementation of the DRA as an additional supplemental rate authority should be beneficial for the Postal Service's financial stability. While the DRA incorporates certain features of the CPI-adjustment factors proposed by both the Public Representative and the Postal Service, there are notable methodological differences between the DRA and the two proposals. The Public Representative has identified certain issues related to the DRA proposal that require correction, clarification or additional justification. The Public Representative presents below a detailed analysis of the proposed DRA formula: specifically, its two components (change in density and the institutional cost ratio) and puts forwards suggestions regarding elimination of potential problems.

a. Change in density

Overview. The change in density component of the DRA formula $\% \Delta D_{[T-1,T]}$ includes two sub-components: change in volume and change in delivery points. The

Commission's formula provided on p. 25 of Attachment A to the RNOPR can be rewritten as follows:

$$\% \Delta D_{[T-1,T]} = \frac{\frac{V_T}{DP_T}}{\frac{V_{T-1}}{DP_{T-1}}} - 1 = \frac{V_T}{V_{T-1}} * \frac{DP_{T-1}}{DP_T} - 1$$

Where

V_T and V_{T-1} = volume in fiscal year T and $T-1$, respectively;

DP_T and DP_{T-1} = delivery points in fiscal year T and $T-1$, respectively;

It is easy to see that change in density is calculated by multiplying the ratio between volume in fiscal year T and volume in fiscal year $T-1$, ($\frac{V_T}{V_{T-1}}$) by the ratio between delivery points in fiscal year $T-1$ and delivery points in fiscal year T , ($\frac{DP_{T-1}}{DP_T}$) and subtracting "1" from the product of these two ratios. Under the assumption that between fiscal year $T-1$ and fiscal year T , the volume decreases and the number of delivery points increases, we will have:

$$0 < \frac{V_T}{V_{T-1}} < 1 \quad \text{and} \quad 0 < \frac{DP_{T-1}}{DP_T} < 1, \text{ which results in: } \% \Delta D_{[T-1,T]} < 0^{11}$$

If the number of delivery points appears stable from year $T-1$ to year T , but the volume decreases, density will still decrease:

$$0 < \frac{V_T}{V_{T-1}} < 1 \quad \text{and} \quad \frac{DP_{T-1}}{DP_T} = 1, \text{ so that: } \% \Delta D_{[T-1,T]} < 0$$

The same conclusion about density decrease will be valid under the assumption of the stable volume and the increased number of delivery points:

¹¹ This is because (-1) is subtracted from the product of these two ratios.

$$\frac{V_T}{V_{T-1}} = 1 \quad \text{and} \quad 0 < \frac{DP_{T-1}}{DP_T} < 1, \text{ so that : } \% \Delta D_{[T-1,T]} < 0$$

The Public Representative concludes that by including both the change in the number of delivery points and change in volume in the DRA formula, the Commission accounts for two factors that generally cause per unit costs to increase. The Public Representative, however, has a concern about certain aspects of the methodology for calculating the change of the density component.

Data source for the number of delivery points. The Commission does not justify its reasons for choosing any particular data source, but notes that reliance on the existing sources limits the need for additional reporting and provides an “additional benefit of transparency for the publicly available inputs used in the formula.” RNPR at 78. The Commission intends to use the annual USPS publication of the Total Factor Productivity (Annual TFP Tables) as a source for the annual number of delivery points. RNOPR at 78. The Postal Service previously suggested this data source as an example of publicly filed “delivery network growth” measures. Postal Service Comments on NOPR at 73, n. 182.

The Public Representative’s review of the Annual TFP Tables shows that this data source includes annual data on “total deliveries,” which are calculated as the sum of deliveries by three categories: city, rural and highway contract delivery.¹² However, the Postal Service’s website about.usps.com provides similar historic information, but includes the number of delivery points for an additional delivery type category: delivery to PO Box.¹³ The total number of delivery points here is the sum of delivery points by

¹² RNPR at 78, 80. See *also e.g.*, USPS Annual Tables, FY 2018 TFP (Total Factor Productivity), July 16, 2018, Excel file “Table Annual 2018 – 2018 CRA Public.xlsx,” worksheet “Out-46” (FY 2018 TFP Tables).

¹³ See <https://about.usps.com/who-we-are/postal-history/delivery-points-since-1905.pdf>.

four categories (city, rural, highway contract, and PO Box) and is higher than the number of deliveries provided in the Annual TFP Tables. See Table 1.

Table 1: FY 2006-2018 Delivery Points by Type of Delivery

Delivery Type	City, Rural, and Highway Contract Deliveries/Delivery Points		PO BOX	Total Delivery Points
Year/Source	TFP*	USPS**	USPS**	USPS**
2006	125.2	126.1	20.1	146.2
2007	127.0	127.8	20.2	148.0
2008	128.4	129.0	20.2	149.2
2009	129.5	130.0	20.1	150.1
2010	130.4	130.8	20.1	150.9
2011	131.1	131.5	20.0	151.5
2012	131.9	132.3	19.9	152.1
2013	132.7	133.3	19.6	152.9
2014	133.8	134.4	19.5	153.9
2015	134.9	135.6	19.4	155.0
2016	136.0	136.9	19.4	156.1
2017	137.3	137.9	19.3	157.3
2018	138.6	139.3	19.3	158.6

* FY 2018 TFP Tables, worksheet "Out-46," column K

** <https://about.usps.com/who-we-are/postal-history/delivery-points-since-1905.pdf>

The Public Representative suggests that the total annual number of delivery points will be more accurate when deliveries to PO Boxes are included in the provided estimates since they also incur costs. In addition, for each year, the sum of city, rural and highway contract deliveries reported in the Annual TFP Tables is consistently lower than the sum of delivery points for these three types of deliveries provided on the Postal Service's website. See Table 1. This observation raises a question whether the

definition of “deliveries” (reported in the Annual TFP Tables) is identical to the definition of delivery points (reported on the about.usps.com website and obtained from the number of the Postal Service’s sources).¹⁴

Accounting for volume declines. In the proposed DRA formula, the Commission considers decline in mail volumes for Market Dominant Mail and for all mail (including Competitive Mail) from fiscal year $T-1$ to year T . The Commission did not consider changes in mail mix for Market Dominant products focusing only on the overall density decline in the network. The DRA formula does not account for mail volume declines either by class (as in the Public Representative’s proposal) or by product (as in the Postal Service’s proposal), which creates a number of problems.

First, the Commission’s formula for DRA does not take into account that not all mail volume declines are equally harmful to the Postal Service’s financial stability. When discussing negative implications of mail volume declines, both the Postal Service and the Public Representative focused on contribution-generating classes of mail, such as First-Class mail and high-contribution products.¹⁵ This is because volume declines for non-compensatory classes (e.g. Periodicals) and products (e.g. USPS Marketing Mail flats) do not have the same negative impact on revenues as volume declines for compensatory classes and products. The proposed formula for density adjustment relies on all mail volumes including volumes for non-compensatory products. Consequently, the formula does not account for the fact that these volume declines do not represent the same challenge to the Postal Service as volume declines for compensatory products. Although it might be complicated to calculate the revenue-weighted volume decrease by each market dominant product, as the Postal Service

¹⁴ These sources include: 1971-2010, Comprehensive Statement on Postal Operations; 2011-2019 Annual Report to Congress and Comprehensive Statement on Postal Operations.

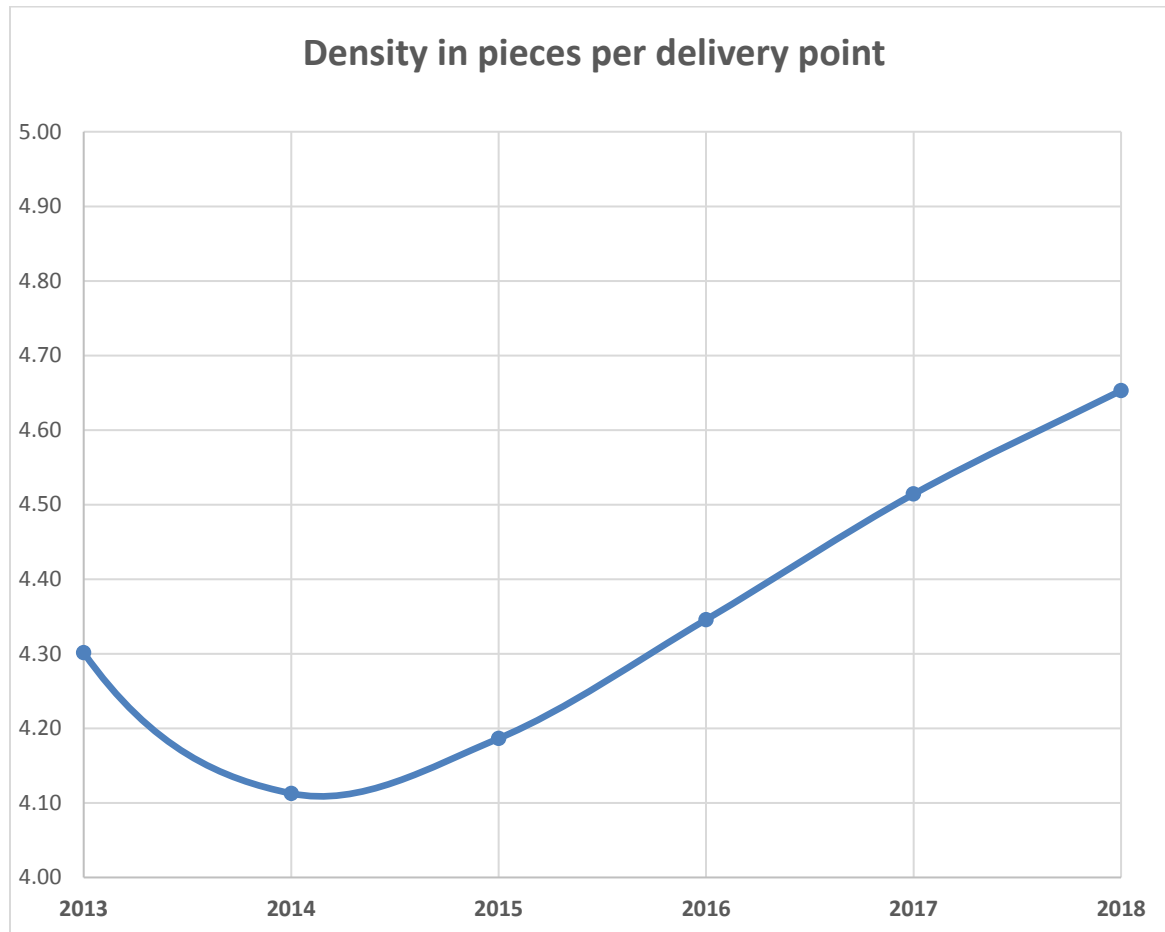
¹⁵ See Postal Service Initial Comments on NOPR at 71; Declaration of John Kwoka and Robert Wilson, March 1, 2018 at 4, 17.

suggests, it is not so difficult to perform such calculations by class of mail. If the DRA formula incorporated the mail volume declines by class of mail, the proposed DRA would better account for different impacts of mail volume declines on different classes of mail.

Second, there is a more serious issue with the calculation of the DRA without considering mail mix. If the amount of the DRA in any particular fiscal year is greater than zero, this additional rate authority will be available for all mail classes including those that do not experience density declines. This is because in accordance with 39 U.S.C. §§ 3622(d)(1) and (d)(2), the annual CPI-U-based rate increase limit “shall apply to a class of mail as defined in the Domestic Mail Classification Schedule.”¹⁶ As Chart 1 illustrates, the Package Services class of mail has not experience year-over-year declines in density in recent years, and it appears unclear why it “deserves” additional rate authority to compensate for per-unit cost increases due to a decline in density.¹⁷

¹⁶ The current Mail Classification Schedule available on the Commission’s website and the proposed revision to the 39 CFR § 3010.101(c) clearly state that there are five classes of mail within market dominant products and services: First-Class Mail, USPS Marketing Mail, Periodicals, Package Services and Special Services. See RNOPR, Attachment A, at 4-5.

¹⁷ In addition, the calculated DRA will also apply to the Special Services class although the change in volume for this mail class is not included in the calculation of the DRA. When using the RPW data on volume, the Commission does not consider volume for Special Services.

Chart 1: Change in Density for Package Services

Sources: Library Reference PRC-LR-RM2017-3/1, file prc-lr-rm2017-3-1.xlsx, tab "Figure II-16;" Docket No. ACR 2017, Library Reference USPS-LR-FY17/1, file PublicFY17CRARReport.xlsx, worksheet "Volume1;" Docket No. ACR 2018, Library Reference USPS-LR-FY18/1, file PublicFY18CRARReport.xlsx, worksheet "Volume1;" FY 2018 TFP Tables, worksheet. "Out-46."

Another issue is the inconsistency between the databases that the Postal Service uses as data sources. The Commission does not justify its reasons for choosing any particular source, but notes that reliance on the existing sources limits the need for additional reporting and provides an "additional benefit of transparency for the publicly available inputs used in the formula." RNPR at 78. The Public Representative agrees, but observes that both the CRA and RPW reports include volume data, but the

Commission proposes to use volume data from the RPW report. The differences between mail volumes provided in the RPW and CRA reports are small, but still exist.¹⁸ The Commission does not explain why it proposes the RPW volumes instead of the CRA volumes for calculating density change although the cost per piece is generally calculated using the CRA data. The Public Representative suggests that a clarification on the issue would increase transparency.

b. Institutional cost ratio

Throughout the RNOPR, the Commission defines and calculates the institutional cost ratio as institutional costs divided by total costs. RNOPR at 26, 72, 74, Attachment A at 25-26. The Postal Service's proposed adjustment included the "share of institutional cost" defined as a "percentage of total costs that are not attributable to products". Postal Service Initial Comments to NOPR at 73. Considering that institutional costs are residuals and represent costs not attributable to products, the "share of institutional costs" in the Postal Service's formula is identical to the "institutional cost ratio" in the Commission's formula.

The Commission, however, is not fully consistent with its own definition of the institutional cost ratio. Thus, on page 71 of the RNOPR, the Commission discusses the effect of changes in volume and delivery points on attributable and institutional costs and states that "[t]he ratio between these costs, known as *the institutional cost ratio*, serves as a useful tool for estimating how costs can be expected to change in response to changes in density." RNOPR at 71(emphasis added). Considering that attributable cost is just a part of the total cost, there is an evident discrepancy between the

¹⁸ Compare, Docket No. ACR 2018, Library Reference USPS-FY18-1, December 28, 2018, Excel file Public_FY18CRARreport.xlsx," tabs "Volume 1" and "Volume 2" with Docket No. ACR 2018, Library Reference USPS-FY18-1, December 28, 2018, Excel file Library Reference USPS-FY18-42, December 28, 2018, Excel file "FY2018_RPWsummaryreport_public_eoy.xlsx," tab "FY 2018 Public."

definitions. In addition, the Public Representative observes that, in the past, the Commission often used the term “attributable/institutional cost ratio,” defined as the ratio between attributable and institutional costs.¹⁹ When referring to the ratio between institutional cost and total cost, the Commission used the term “institutional cost share,”²⁰ the same term that the Postal Service uses when it proposes the CPI-U price cap adjustment factor. Considering that the consistency of terms and definitions is very important, the Public Representative encourages the Commission to provide a clarification and make any applicable corrections.

When discussing the reasons for applying the institutional cost ratio to develop the DRA formula, the Commission states that it would be possible “to approximate how much the year-over-year decrease in density drives an increase in per unit cost.” RNOPR at 71-72. The RNOPR does not include any workpapers to support this statement. The Public Representative finds this confusing. Although the increase in delivery points would generally increase institutional costs, as the Commission claims, the institutional cost ratio (calculated as the share between institutional and total costs) does not provide sufficient information about the actual change in per-unit costs due to a decline in density. This is because per unit costs are calculated as the ratio between attributable costs and volume. The data presented by the Commission in the RNOPR show that the institutional cost ratio has been decreasing in the past few years although density has been declining. See Table 2. The Commission should clarify its use of the term institutional cost ratio.

¹⁹ See FY 2015 Financial Analysis Report at 46, FY 2014 Financial Report at 36, citing the paper sponsored by the Commission where the ratio between attributable and institutional was characterized as “variability ratio” (Robert Cohen and John Waller, The Postal Service Variability Ratio and Some Implications, October 7, 2014 at 1), available at <https://www.prc.gov/sites/default/files/reports/Cohen-Waller%20Final%20Report%201-100714.pdf>.

²⁰ See, e.g., Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2016, March 31, 2017 at 31, 39; Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2015, March 29, 2016 at 35, 45.

Table 2

Financial Years	Change in Density (%)		Change in the Institutional Cost Ratio
	MD Mail	All Mail	
2016-2017	-4.53%	-4.04%	-4.53%
2017-2018	-3.41%	-2.95%	-1.49%

Source: RNOPR at 80, Table IV-3.

C. The Mechanism Proposed by the Commission to Adjust the Price Cap for Retirement Obligation Rate Authority Requires Several Changes

The Commission's proposed mechanism would provide the Postal Service with additional authority to generate revenues to amortize unfunded liabilities for three statutorily mandated retirement obligations: the unfunded liabilities for Retiree Health Benefits (RHB), the Civil Service Retirement System (CSRS), and the Federal Employee Retirement System (FERS). RNOPR a 91. The amount of the additional authority would be determined annually and would be phased-in over 5 years. *Id.* In order to be eligible for the full rate authority, the Postal Service would be required to make minimum amortization payments toward its unfunded retirement liabilities based upon the amount of revenue raised from the additional rate authority during the previous fiscal year. *Id.*

In his comments responding to the Commission's NOPR, the Public Representative advocated adjustments to the price cap that would enable the Postal Service to recover uncontrollable costs for unfunded RHB, CSRS, and FERS liabilities. PR Initial Comments at 43-55. These costs are statutorily mandated, actuarially determined, and billed and collected by the Office of Personnel Management (OPM). As such, these are exogenous costs and the authority to collect them by means of an

adjustment to the price cap is fully supported by established price cap theory²¹ and the record in this proceeding.²²

The Commission's duty to address exogenous retirement benefit costs was not eliminated by the possibility that Congress may at some future date enact legislation that reduces the financial impact of those costs. As the Public Representative pointed out in his prior NOPR comments, the likelihood is that enactment of one of the most recent bills to deal with those costs would not eliminate the need for regulatory action. PR Initial Comments at 51-55. The Commission correctly acknowledged its duty to act in the RNOPR. See RNOPR at 91.

Although the Commission's proposal is an important step in the right direction, several aspects of that proposal require modification. These are: (a) the requirement that a portion of retirement obligations be allocated to Competitive products; (b) the features of the recovery mechanism that will delay the beginning of supplemental revenue recovery; (c) the requirement that cap adjustments be phased in over a period of 5 years; and (e) conditions on the use of the supplemental recovery mechanism. Each of these shortcomings should be corrected for the reasons discussed below

1. The Commission should eliminate or reduce the allocation of institutional costs to Competitive products

The formula proposed by the Commission for calculating the annual amount of supplemental rate authority for uncontrollable retirement obligations improperly allocates a portion of those costs to Competitive products. It accomplishes this by calculating "the percentage amount by which revenue on all products (both Market Dominant and Competitive) would need to increase to make the full payment (as calculated by OPM)." RNOPR at 91-92. This methodology effectively allocates the

²¹ Kwoka/Wilson Decl. at 7-10.

²² Order 5337 at 88-91.

uncontrollable retirement obligations to Competitive products on the basis of revenue. The Commission acknowledges that by “raising prices by that percentage only on Market Dominant products will not generate enough additional revenue to make the full amortization payment...[and that to]...generate that much additional revenue the Postal Service would also need to implement an equivalent price increase on Competitive products.” *Id.* at 93.

There are several problems with this proposed methodology. See PR Reply Comments at 21-27. As the Commission itself expressly acknowledges, the exogenous retirement costs that the Commission seeks to allocate to Competitive products are institutional costs. RNOPR at 90. If this methodology is adopted it would be the first time the Commission has allocated institutional costs to Competitive products and this allocation would be inconsistent with prior Commission rulings that institutional costs should not be allocated to Competitive products on the basis of revenues. See PR Reply Comments at 23-24.

Adoption of the proposed allocation methodology would also be inconsistent with the Commission’s rejection of the argument that different types of institutional costs should be allocated to Competitive products on different bases.²³ Adoption of the proposed methodology would effectively raise the appropriate minimum share of institutional costs that is otherwise determined by the formula adopted by Order No. 4963.

The adoption of this allocation methodology would also ignore the fact that Competitive products are already contributing to institutional costs. *Id.* at 23. That contribution is already substantial. PR Reply Comments at 23. That fact makes it highly questionable whether, as the Commission appears to expect, the Postal Service would be able to implement the “equivalent price increase on Competitive products”

²³ Docket No. RM2017-1, Order Adopting Final Rules Relating to the Institutional Cost Contribution Requirement for Competitive Products, January 3, 2019 (Order No. 4963).

needed to make full amortization payments by the end of the 5-year transition period. Without equivalent revenues from Competitive products, significant shortfalls in supplemental revenue will be virtually guaranteed. Competitive products and the prices the Postal Service charges for those products are subject to the competitive pressures of the marketplace. The Commission is assuming, without support, that the Postal Service is not already pricing Competitive products at or near what the market will bear or that new opportunities to increase competitive product prices will exist in the next 5 years.

The potential for under-collection of the Postal Service's exogenous retirement costs is clearly indicated in the RNOPR. According to the illustrative calculations contained in Table IV-5 on page 100 of the RNOPR, the Postal Service could be required to make a statutorily mandated amortization payment to OPM of \$3.2billion. By contrast, the Postal Service's required minimum remittance in 2026 (of amounts collected from Market Dominant customers in 2025) would be only \$1.776 billion. See Table IV-7 on page 101 of the RNOPR. This means that slightly less than half of the \$3.2 billion payment to OPR would have to come from an "equivalent price increase on Competitive products." On their face, these tables highlight the unlikelihood that the proposed allocation methodology will enable the Postal Service to generate enough additional revenue to make one full statutorily mandated amortization payment to OPM by the end of the 5-year phase-in period.

Nor does the Commission demonstrate or explain how the actual amount of additional revenue from the supplemental rate authority for exogenous retirement costs will be calculated. This calculation is necessary in order to know whether Market Dominant products are over- or under-collecting the supplemental amount authorized. The same is true for Competitive products. Unless the actual amount of exogenous retirement costs recovered from Competitive products can be calculated, the Commission will not be able to determine whether its supplemental rate authority for such exogenous costs is functioning as intended. The importance of determining actual

revenues recovered from both Market Dominant and Competitive products for the Commission's recovery mechanism has important implications for the requirement that the Postal Service make annual minimum payments to OPM of statutorily mandated amortization payments. Problematic aspects of the minimum annual payment obligation are discussed in Section V.C.3.a.i., below.

If the Commission nevertheless decides to abandon its prior position against the use of revenues to allocate institutional cost responsibility on the basis of revenues and to require the allocation of a portion of the Postal Service's exogenous retirement costs to Competitive products on that basis, it should, for consistency, limit that allocation to the minimum contribution percentage calculated by the formula adopted by Order No. 4963 and set forth in 39 CFR § 3015.7(c)(1). That percentage is currently 8.8 percent.²⁴ This smaller allocation, like the larger allocation proposed by the Commission, will reduce the likelihood that the Postal Service will be able to generate additional revenue equal to its statutorily mandated payment obligation. But it would better enable the Postal Service to collect revenues of the magnitude needed to make the required payments to OPM.

2. The Commission should make several modifications to the mechanism for phasing in price cap adjustments for retirement obligation rate authority

The additional price cap authority for the Postal Service's uncontrollable retirement obligations would be phased-in over a 5-year period. RNOPR at 95. The proposed mechanism "is designed to add sufficient additional rate authority so that at the end of that 5-year period, the Postal Service should generate sufficient additional revenue to pay for the amortization segment of the Postal Service's liability, if accompanied by an equivalent rate increase on Competitive products." *Id.* The

²⁴ Docket No. ACR2018, Annual Compliance Determination Report, Fiscal Year 2018 at 116-117, April 12, 2019 (FY 2018 ACD).

purpose of the phase-in is “to create a predictable and stable schedule for rate increases while minimizing the impact on mailers.” *Id.*

The proposed phase-in mechanism suffers from at least two serious deficiencies: the date by which the Postal Service will have the opportunity to begin generating additional revenues is unreasonably delayed and the duration of the phase-in period is too long. Together, these deficiencies will unnecessarily delay the collection of significant additional revenues.

- a. The Commission should revise its phase-in mechanism to prevent unreasonable delays in the collection of supplemental retirement obligation revenues

Under the procedure proposed by the Commission, the Postal Service must file a notice by December 31 of each calendar year under which it calculates the amount of additional rate authority available as Supplemental Rate Authority. RNOPR at 96 and § 3010.181(b). Preapproval of that amount by the Commission is required for additional rate authority to be authorized. RNOPR at 96 and § 3010.181(c). Unless and until the Commission issues that approval, supplemental rate authority will not be available. Missing from the regulations is a deadline for Commission action. Since OPM billing of retirement obligations has occurred as early as June and July,²⁵ the Postal Service could be in a position to calculate its supplemental rate authority in time for inclusion in an annual market dominant rate filing the following October of the same calendar year.²⁶ However, to be able to include amounts billed by OPM for retirement obligations during

²⁵ See, e.g., Letter from Dennis D. Coleman, Chief Financial Officer, Office of Personnel Management to Joseph Corbett, Chief Financial Officer, United States Postal Service, June 28, 2017 (regarding supplemental CSRS liability); Letter from Dennis D. Coleman, Chief Financial Officer, Office of Personnel Management to Joseph Corbett, Chief Financial Officer, United States Postal Service, July 30, 2017 (regarding unfunded retiree health benefits).

²⁶ Notices of generally applicable Market Dominant price increases are typically filed during October. See, e.g., Docket No. R2020-1, United States Postal Service Notice of Market-Dominant Price Change, October 9, 2019.

June or July as part of an October market dominant price change notice, the Commission would have to issue approval in time for the Postal Service to include the approved amount in a rate adjustment filing. Without a deadline for Commission action on the Postal Service's supplemental rate authority notice, the Postal Service will have little assurance that it will be able to exercise its right to collect supplemental revenue in a timely manner. At a minimum, a deadline for Commission action should be included in the proposed regulations. The deadline should permit the Postal Service to make a timely rate adjustment filing.

An even more fundamental issue is raised by the requirement that the Postal Service must seek special approval for the collection of supplemental rate authority. The Commission has not explained its reasons for this requirement. The formulas for calculating supplemental revenue will be available to the Postal Service just as are the Commission-established formulas for calculating CPI-U adjustments used by the Postal Service to make annual market dominant price adjustments. If Postal Service calculations and documentation for CPI-U adjustments in market dominant price change notices are adequate for purposes of Commission review, there would appear to be no reason why support for supplemental rate authority in the same market dominant price change notices would not also be adequate. The proposed process for Commission pre-approval of supplemental rate authority appears to be unnecessary and a potential obstacle to the Postal Service's timely collection of supplemental revenues.

The significance of any delays caused by the proposed pre-approval process can be demonstrated by reference to the illustrative examples in the Commission's revised notice of proposed rulemaking. See RNOPR at 99-103. The examples of hypothetical rate authority formula outputs provided in Table IV-6 on page 100 of the RNOPR show that Commission authority to collect supplemental rates for retirement obligations that is not issued until January 31 would preclude the Postal Service's exercise of

supplemental rate authority until the following September.²⁷ For example, even though the Postal Service will have received a bill from OPM during the summer of 2020, the Postal Service will have to wait over a year, until September, 2021, to *begin* collecting supplemental revenues related to the summer 2020 OPM bill. Unless adequate reasons can be given to support the pre-approval process, the Commission should eliminate the entire process. Elimination of the process would not prevent the Commission for reviewing the Postal Service's calculations, just as it reviews CPI-U adjustments in every annual Postal Service market dominant price adjustment notice.

If the Commission nevertheless decides to include the pre-approval process, it should explain why it is necessary. The Commission should also give the Postal Service the option of filing its first supplemental rate adjustment independent of a generally applicable rate adjustment in order to avoid delays in collection that would otherwise result from delays in the adoption of the Commission's proposed regulations. If, for example, issuance of the Commission's regulations were to be delayed until after OPM's annual retirement obligation billings are received by the Postal Service in June and July of 2020, the Postal Service could be precluded from filing for a supplemental revenue adjustment until late 2021. The option to file a rate adjustment before the next generally applicable rate adjustment would avoid such an unnecessary delay in recovering supplemental revenues.

²⁷ The Commission notes that the dates of authorization for supplemental authority shown in Table IV-6 are included for illustration and are not formula-bases, inputs or outputs. RNOPR at 101. Be that as it may, the important fact that nothing in the proposed regulations would preclude pre-approval being issued as late as January 31 in any one of the fiscal years presented in Table IV-6.

- b. The Commission should revise its phase-in mechanism to shorten the phase-in period to four years

The Commission proposes to phase-in the additional price cap authority for the statutorily mandated amortization portion of the Postal Service's uncontrollable retirement costs over a 5-year period. RNOPR at 95. The Commission states that its phase-in method "is designed to create a predictable and stable schedule for rate increases while minimizing the impact on mailers." *Id.* The proposed mechanism is designed to produce additional market dominant revenues which, together with equivalent Competitive product rate increases, would be enough to pay a full amortization payment. *Id.* at 99.²⁸

The Commission presents four formulas to show how the additional rate authority would be calculated for each year of the 5-year period. *Id.* at 96-99. A hypothetical example is given and a series of three tables (Table IV-5, Table IV-6, and Table IV-7) presented to demonstrate how the calculations would be made. *Id.* at 99-103. The example assumes that the Commission's proposed rules will be adopted prior to December, 2020. *Id.* at 99. The scenario is hypothetical and presented for illustrative purposes and not as a forecast.

The Public Representative supports the adoption of a phase-in mechanism. However, a 5-year period is too long and could deny the Postal Service a reasonable opportunity to recover its uncontrollable retirement benefit costs.

Ironically, the Commission's illustrative example supports the reasonableness of a 4-year phase-in period. That support derives from data presented in Table IV-5, Table IV-6, and Table IV-7. RNOPR at 100, 101. The relevant data is displayed in the following table:

²⁸ In Section V.C.1., above, the Public Representative challenges the decision to rely upon equivalent Competitive product price increases to cover statutorily mandated retirement amortization payments. As discussed there, the Commission should, at most, allocate responsibility to Competitive products in line with the institutional cost rule adopted by Order No. 4963.

Table 3:
Selected Data from Hypothetical Example
(Sources: Order No. 5337, Tables IV-5 and IV-7)

FY	Statutorily Mandated Amortization Payment (Millions)	Required Minimum Remittance (Millions)	To Be Remitted By
2021	\$3,000	\$31	September 30, 2022
2022	\$3,200	\$416	September 30, 2023
2023	\$3,500	\$820	September 30, 2024
2024	\$3,400	\$1,269	September 30, 2025
2025	\$3,200	\$1,776	September 30, 2026
2021- 2025	\$16,300	\$4,312	

For the five fiscal years from FY 2021 through FY 2025, the Postal Service's statutorily mandated amortization payments total \$16.3 billion. Supplemental revenue to make these payments is shown in the column headed "Required Minimum Remittance (Millions)". The total amount of supplemental revenue from market dominant products is \$4.312 billion. Each required minimum remittance "is equal to the amount of additional revenue collected during the *previous* fiscal year as the result of the prorated, compounded rate increase resulting from the use of retirement rate authority." RNOPR at 101 (*italics in the original*).

Of particular significance is the \$31 million required minimum remittance (*i.e.* revenue) for FY 2021. That remittance is over \$380 million less than the required remittance (*i.e.* revenue) shown for FY 2022. The \$31 million remittance/revenue for FY 2021 is also substantially below the amount of increase in required remittances/revenues each year from FY 2021 through FY 2025. Between each of those fiscal years, remittances/revenues increased by over \$400 million.

The reason for the disparity between remittances/revenues for FY 2021 and the other four fiscal years is provided by Table IV-6. The entries for FY 2021 on that table show that the authorized supplemental rate increase for that fiscal year is shown as going into effect on September 2, 2021. That date, September 2, 2021, is less than one month before the end of FY 2021 on September 30, 2021. The \$31 million remittance/revenue for FY 2021 is due to the fact that supplemental revenues for FY 2021 were collected in just under one month.

The significance of the disparity between remittances/revenues for FY 2021 and the other five fiscal year is that, as Table 1, above shows, most of the \$4.312 billion of supplemental revenue (*i.e.*, \$4.281 billion, or 99.3 percent) was collected in only four fiscal years—FY 2022 through FY 2025. What this demonstrates is that a four year phase-in period is just as effective as the Commission’s proposed five year phase-in period in creating “a predictable and stable schedule for rate increases while minimizing the impact on mailers.” RNOPR at 95.

A further demonstration that a 4-year phase-in period can produce results nearly identical to the Commission’s 5-year phase-in mechanism, is provided by the following table:

**Table 4:
Required Minimum Remittances Phased-In Over a 4-Year-Period**

Financial Year	Additional Retirement Rate Authority on October 1 of the previous FY	% of MD Revenue in Previous FY Resulting from Retirement Rate Authority	Required Minimum Remittance (Millions)
2022	0.000%	0.000%	\$0
2023	0.861%	0.853%	\$399
2024	0.827%	1.668%	\$791
2025	0.918%	2.562%	\$1,230
2026	1.111%	3.632%	\$1,746

The Public Representative applies the input data and additional Retirement Rate Authority as the Commission provided in Tables IV-5 and IV-6 of the RNOPR. Instead of having a rate increase on September 2, 2021 (just one month before the end of the FY 2021), the Public Representative moved the date of rate increase to October 1, 2022. When the Retirement Rate Authority is phased-in over the full 4-year period, the required minimum remittance for the fourth year is almost the same as in the Table IV-7 of the RNOPR. See RNOPR at 100-101.

In making this comparison, the Public Representative acknowledges that the Commission's hypothetical example is only for illustrative purposes and does not purport to be a forecast. RNOPR at 99. However, the important fact is that the Commission's own illustrative examples illustrate that a 4-year phase-in mechanism, no less than a 5-year phase-in schedule, can provide a predictable and stable schedule for rate adjustments that minimizes the impact on mailers.

The advantage that the 4-year phase-in mechanism has over the 5-year mechanism is that it will ensure that the Postal Service has the opportunity to begin collecting full supplemental revenues one year earlier. By contrast, the 5-year phase-in mechanism may not permit collection of full supplemental revenues by the fourth year. To the extent the 5-year mechanism delays the Postal Service's opportunity to collect full supplemental revenues, it unnecessarily limits the Postal Service's ability to improve its financial situation. Accordingly, the Public Representative urges the Commission to adopt a 4-year phase-in mechanism.

3. The Commission should eliminate the RNOPR's conditions that could result in forfeiture of the Postal Service's option to file for supplemental rate authority

The proposed rules providing for supplemental rate authority state that if any one of three itemized circumstances occur, "the Postal Service shall *not* be eligible for *future* retirement obligation rate authority under this subpart, and the Commission may commence additional proceedings as appropriate." RNOPR, Attachment A, § 3010.185 Forfeiture at 35 (emphasis added). The three circumstances are:

--if the Postal Service fails to file a notice, required under § 3010.181(b) within 45 days of the effective date of this section, by December 31 of each year that calculates the amount eligible for rate authority under this provision;

--in any year the Postal Service fails to timely file a rate increase for the full amount of the retirement obligation authorized for that fiscal year to take effect prior to the end of that fiscal year; or

--in any year the Postal Service's total payments to OPM toward supplemental and unfunded liabilities are not at least as great as the minimum remittance required under the proposed rule in § 3010.184(a).

The Public Representative strongly urged the Commission to insert a price cap adjustment for exogenous retirement costs and, as noted above, the Commission has accepted that proposal. Authorizing a supplemental rate authority adjustment is necessary, but it is quite another step to essentially require the Postal Service to implement the supplemental rate adjustment for the retirement obligation each year of the phase-in and to require those revenues collected to be paid to a particular creditor or forfeit the opportunity for future authority altogether. In the Public Representative's view, the Commission should reconsider and eliminate each of the three conditions that must be met to avoid forfeiture of that supplemental authority, or at least clarify the forfeiture procedure if payments are not made by the Postal Service to OPM. The

Public Representative first addresses the third of the above conditions that to avoid forfeiture of this supplemental rate authority the Postal Service must pay OPM the minimum remittance required.²⁹

- a. Payment of minimum remittances to OPM should not be required as a condition for future supplemental rate authority
 - i. The minimum remittance provides little or no incentive to pay OPM

The required minimum payment likely has a perverse impact on the Postal Service's finances. If the Postal Service must pay out to OPM all revenue that it collects from the supplemental retirement authority, there will likely be little or no incentive for the Postal Service to file for those rates.³⁰ Indeed, the elasticity effect of including the supplemental retirement authority in its rates will reduce subsequent mail volumes. Unless the proposed volume or density adjustment eliminates entirely the revenue impact of that volume loss, the net revenue allowed to be retained by the Postal Service from the supplemental authority will be less than the revenue it would have if the Postal Service did not file for the supplemental authority. Thus, the Postal Service will have little or no incentive to utilize its supplemental authority in the first place.

There are several additional reasons for eliminating the requirement to pay OPM:

--Although the calculations of the formula for the minimum remittance is explained in detail, the Commission does not provide any reason for the minimum remittance.

²⁹ It appears that the minimum remittance is intended to be equivalent to all the revenue collected under supplemental authority. The rule requires that all revenue collected under the supplemental authority must be paid to OPM. RNOPR, Appendix A, § 3010.184(a) at 31.

³⁰ The RNOPR would require a minimum payment to OPM calculated as "equal to the amount of revenue raised from the additional rate authority during the previous fiscal year." RNOPR at 91. The Commission's minimum requirement assumes the revenue collected equates to the supplemental authority filed for and implemented.

--Costs are compiled to determine rate allowances, but revenue from allowed rates are never earmarked by the Commission to require payment of a specific cost.

--There are currently no consequences for failure to pay OPM the amortization amount except for a book entry liability on the Postal Service's financial statements.³¹

--While the Postal Service should not cavalierly default on its obligations, its management has recently decided it was necessary to default on its obligations in order to pay off some debt and build up its working capital.³²

- ii. The proposed condition should be clarified as to whether a failure to pay supplemental authority revenue to OPM would result in the immediate forfeiture of future supplemental authority or would result in forfeiture only after Commission review in an ACD or other proceedings

The RNOPR states, "[r]egardless of whether the Postal Service implements such a competitive rate increase, the full amount of additional revenue actually collected from Market Dominant products as a result of this retirement rate authority must be submitted towards the Postal Service's amortization payment." RNOPR at 93. The RNOPR continues: "If the Postal Service fails to make the required partial payment in any given year, it would automatically forfeit the balance of the additional authority."

³¹ The Postal Service has stated: "As of September 30, 2019, past due amounts payable to the PSRHBFB totaled \$47.2 billion, past due amounts payable to OPM for CSRS totaled nearly \$4.8 billion and past due amounts payable to OPM for FERS totaled \$3.4 billion. We have incurred no penalties or negative financial consequences resulting from our inability to make these payments." United States Postal Service, 2019 Report on Form 10-K, filed November 14, 2019 at 40.

³² "The source of funds needed to fulfill these commitments [for capital expenditures and to meet statutory obligations to provide prompt, efficient and reliable postal service to the nation] has been generated from our operating activities and defaults for non-payment on certain retirement and retiree healthcare obligations." *Id.* The Postal Service also reduced its debt to the U.S. Treasury in 2019: "During 2019, we further reduced our debt level by \$2.2 billion, lowering it from \$13.2 billion to \$11.0 billion. We currently have no plans to change our debt level during 2020." *Id.* at 41.

RNOPR at 95.³³ After the phase-in period is complete, the Postal Service must use the revenue generated to make amortization payments. *Id.* at 95 n.177.

The specific language of the proposed rule that the Postal Service will not be eligible for future retirement obligations seems to be tempered somewhat by text in the body of the RNOPR that the Commission will review the status of partial payments in each ACD and “may” order cessation of rate of retirement rate authority “if these payments are not made.” And further, “[a]t the Commission’s discretion, additional equitable remedies, including potential adjustments to rates and/or rate authority, may be implemented if the Postal Service avails itself of the retirement authority without making partial payments.” *Id.* at 93. This language is at odds with the statement in the proposed rule at § 3010.185(a) that, if any of the conditions are not met, the Postal Service *shall not* be eligible for future retirement obligation rate authority but that “the Commission may commence additional proceedings as appropriate.” RNOPR, Attachment A at 35 (emphasis added).

Some clarification of the Commission’s discussion would be desirable. Although the proposed rule would specifically require the forfeiture of future retirement obligation rate authority if the payments are not made (subject to the Commission commencing “additional proceedings as appropriate”), the body of the RNOPR indicates the rule is not so final and that the Commission “may order cessation of retirement rate authority if these payments are not made,” even though the proposed rule clearly states the Postal Service “shall not be eligible for future retirement obligation rate authority.” RNOPR at 93, Attachment A, § 3010.185(a) at 35. Therefore, the Commission should clarify whether future supplemental retirement obligation rate authority will be forfeited immediately or whether it might be forfeited only after Commission review in an ACD or

³³ “[T]he Postal Service will continue to be required to remit towards its amortization payments all revenue collected as a result of the use of retirement rate authority.” *Id.* at 95-6.

in other proceedings if the Postal Service's supplemental authority revenue is not paid to OPM.

- b. Annual timely filing for supplemental retirement obligation rate authority should not be required as a condition for future supplemental retirement rate authority

Apart from the problematic condition placed on the supplemental retirement obligation authority that the Postal Service must pay OPM all revenues collected pursuant to the supplemental authority for retirement benefits, the Commission should also reconsider and delete the other two conditions requiring the Postal Service to timely file for supplemental authority in each of the phase-in years or else lose its option for supplemental authority. See proposed § 3010.185(b) and (c). As noted above, the rules would provide that if the approval of supplemental rate authority is not requested within 45 days of the effective date of § 3010.185 or notice is not filed as required under § 3010.181(b) for retirement obligation rate authority, or if not requested in any year to be effective prior to the end of that fiscal year, then supplemental authority will be or may be forfeited.

First, the Public Representative is concerned that the Commission does not present any reasons for including the forfeiture rules in these regulations, but leaves the rationale for surmise. The RNOPR explains that the allowance for supplemental authority balances the need "to provide the Postal Service with a path to financial stability while reasonably balancing the interests of the mailing community" and minimizing the impact on mailers by spreading the rate increase over time. RNOPR at 94. And that it is designed "to create a predictable and stable schedule for rate increases." *Id.* at 95. These are reasons for permitting the supplemental authority, yet the RNOPR does not explain why the Commission has included the conditions of forfeiture to eliminate the benefits of the supplemental allowance if the Postal Service foregoes timely application of the supplemental rate authority. § 3010.185(b)-(c).

Forfeiture of the very important supplemental rate authority for all future years of the phase-in period for failing to timely file for its benefits in any one year is onerous. It penalizes the Postal Service unnecessarily. In this proceeding, the Public Representative has continually pointed out the necessity for Postal Service authority to recover the exogenous costs of its retirement obligations. These costs accrue on the Postal Service's books whether or not they are actually included in rates or paid to OPM. *Id.* at 90. If the Postal Service does not avail itself of the authority in one year to include full amount of the supplemental authority in its rates, costs will continue in future years in any event. The Postal Service should continue to have the opportunity to file annual rate adjustment proposals to recover these constantly accruing costs whether or not the Postal Service files to collect the rates each year. There are several reasons for removing both of these proposed forfeiture provisions.

- The RNOPR does not offer any reasons to justify the forfeiture provision in the RNOPR. The previous orders in this docket did not discuss this issue because they did not provide for specific supplemental authority for retirement obligations.
- No good reason is apparent why, if supplemental rate authority is forgone in one period, it should be forever forfeited. If anything, forgoing supplemental rate authority in one year creates all the more need for the foregone rate increase in future years even though the Postal Service will not be able to make up the revenue lost during the foregone year.
- The possibility of forfeiting supplemental rate authority reduces the stated advantage of the supplemental authority over the 5-year period in the first place "to create a predictable and stable schedule for rate increases." *Id.* at 95.
- The supplemental rate authority granted by the proposed rules, as well as the price cap limitation under the PAEA, are only rate *ceilings* subject to voluntary filing by the Postal Service to collect these rates and are not required rates.

- Because the Commission does not have authority to *require* the Postal Service to file for these particular rates, the only implicit reason for the forfeiture conditions appears to be to act like a stick to effectively force the Postal Service to file for such rates each year to utilize this authority.
- Requiring forfeiture of future authority to recover recognized exogenous costs is inimical to the principle that exogenous costs are legitimately incurred and should be recoverable whenever necessary as the Postal Service chooses.
- There may be business reasons within the purview of management in one year but not in the next year or in subsequent years why the Postal Service may not seek to collect the full amount of supplemental authority rates every year.
- Requiring forfeiture of future supplemental rate authority will only unnecessarily exacerbate the Postal Service's financial difficulties.

Given the lack of any justification and apparent lack of reasonable justification for the forfeiture conditions proposed to be placed on the supplemental authority rules, the Public Representative believes that the Commission should delete in its entirety proposed § 3010.185, from the proposed rules.

- c. The requirement that the Postal Service seek recovery of the maximum authorized rate authority should be eliminated and banking of unused supplemental rate authority should be permitted.

Under the Commission's proposal, the failure of the Postal Service to include the "full amount of retirement obligation rate authority authorized by [the Commission] under this subpart during that fiscal year, prior to the end of that fiscal year" shall be forfeited. See proposed § 3010.185(c). In addition, banking of approved, but unused, rate authority is prohibited. § 3010.181(5).

The requirement that the Postal Service include the full amount of authorized supplemental rate authority in its rate adjustment filing is both unnecessary and potentially self-defeating. As a practical matter, the Postal Service has an incentive to collect as much as possible of its mandatory retirement obligation costs. Market forces could, however, cause demand to fall if the Postal Service is required to seek recovery of the full authorized amount in a given year. In such a case, the Postal Service faces the possibility that at some point overall revenues will fall. Not only would the Postal Service's prerogative to price its products be taken away, but its finances would be unnecessarily damaged—an ironic result from a regulatory provision that is ostensibly intended to benefit the Postal Service.

Similarly, the denial of banking authority is an unnecessary and unexplained limitation on the collection of authorized supplemental revenues. The amount of supplemental rate authority will be limited by the proposed phase-in mechanism. That mechanism limits both the annual amount of additional revenue the Postal Service can seek to recover during each year of the phase-in period and the length of the phase-in period. These limitations, together with the Postal Service's obligation to make statutorily mandated amortization payments for decades and its incentive to collect as much supplemental revenue as possible every year, there appears to be no reason to deny the Postal Service the authority to bank authorized amounts that it does not, as a matter of business judgment, consider prudent to include in a proposed rate adjustment. Moreover, the proposed authority to seek collection of, or bank, exogenous costs will be subject to review in the Commission's next market dominant system review.

VI. COMMISSION'S PERFORMANCE-BASED RATE AUTHORITY PROPOSAL

In the revised NOPR, the Commission maintains its position that additional, performance-based rate authority is necessary to enable the Postal Service to accumulate retained earnings that can be used to finance capital improvements. The Commission reiterates its finding that the existing regulatory system resulted in a breakdown of the Postal Service's "financial health cycle," frustrating Objectives 1, 3, and 5. RNOPR at 105-106. The Commission restates that the Postal Service's growing deficits and exhausted borrowing authority "corresponded to drastic decreases in the Postal Service's capital outlays." *Id.* at 106 (citing Order No. 4258 at 49-51). The Commission concludes that "without retained earnings, the Postal Service is unable to finance the capital investments necessary to sustain its financial health cycle." *Id.*

However, in response to comments, the Commission made two modifications to its initial proposed rule. *Id.* at 105. First, the Commission merged two of the proposed additional rate authorities: 0.75 percent for operational efficiency and 0.25 percent for maintenance of service standards. *Id.* The revised proposed rule allows for 1 percent of additional rate authority if the Postal Service meets both the efficiency and service benchmarks, eliminating the possibility that the Postal Service qualifies for one of these incentives and not the other. *Id.* Second, the Commission altered the efficiency benchmark under the proposed rule, opting for "year-to-year" changes in TFP, in lieu of the rolling 5-year average that was initially proposed. *Id.*

The Public Representative continues to object to the proposed performance-based rate authority. The Commission's RNOPR does not address issues previously identified during this rulemaking process. As reformulated, the authority remains backward-looking and directed at the symptoms of the Postal Service's problems instead of addressing the causes. The modification to the method for evaluating changes in the Postal Service's efficiency is inferior to the methodology initially proposed. As explained below, the proposal is also designed to function over a lengthy

period of time, frustrating its purpose. For these reasons, the Public Representative contends that the Commission should not pursue performance-based rate authority or, in the alternative, should allow a significantly longer period for evaluation of efficiency changes.

A. The Commission's Proposed Modifications Do Not Address Previously Identified Issues

Unfortunately, the proposed modifications to the initial proposed rule do not address the serious concerns about the performance-based authority raised by the Public Representative in prior comments. PR Initial Comments at 30-37. As the Public Representative previously explained, there are a litany of issues with both the efficiency and service performance components of the proposed performance-based rate authority. Among others, the proposed performance-based authority is backwards-looking and an inadequate incentive for the Postal Service. Below, the Public Representative examines how several of these previously identified issues are addressed by the RNOPR, in general and in the proposed modifications, and suggests revisions to the proposal for performance-based authority and the timeframe for evaluating efficiency.

1. The basis for calculating performance-based rate authority should not be backward-looking

The Commission's basis for calculating the amount of performance-based rate authority remains backward looking. Instead of assessing the Postal Service's future needs for capital investment, the Commission "[took] into account multiple reference points, including the amount of capital spending and the value of assets pre-PAEA compared to post-PAEA and the amount of borrowing authority exhausted during the PAEA era." RNOPR at 122 (citing NOPR at 54). After considering these historical reference points, the Commission "applie[d] its expert judgment in postal matters to

determine that 1 percentage point per annum is the appropriate amount of performance-based rate authority.” *Id.*

The Public Representative believes that any analysis of the Postal Service’s capital requirements should be forward-looking and based on the Postal Service’s future capital investment needs. Nevertheless, it is difficult to parse out the Commission’s reasoning for determining why one percent is the appropriate amount of rate authority. This is primarily because the Commission states that that this one percent of additional rate authority “was not intended to provide the Postal Service a specific level of retained earnings or a set amount of funding for capital investment.” *Id.* It appears that the Commission reviewed the Postal Service’s historical capital spending and determined that some additional authority is needed but did not want to anchor the authority to a specific amount. The Commission then underwent an unexplained process of analyzing these reference points to arrive at the one percent amount. If the Commission retains the proposed additional rate authority, the Public Representative believes that the Commission must explain more clearly how it analyzed the reference points and arrived at the one percent amount of performance-rate authority. Otherwise, an appellate court will be unable to determine the Commission’s reasoning and might be unwilling to defer to the Commission’s “expert judgement in postal matters.”

2. The Performance-Based Authority would provide an inadequate incentive

Furthermore, the Public Representative maintains his position that the proposed rate authority will be an inadequate incentive. Generally speaking, with regard to efficiency, the Postal Service does not require incentives. As a firm under long-standing financial duress, the Postal Service has operated under significant incentives to increase its efficiency for a significant period of time. With regard to service quality, the proposed solution is focused on the “symptoms” instead of addressing the underlying issues with inadequate capitalization. See PR Initial Comments at 36 (quoting Kwoka

and Wilson Declaration). Until the Postal Service achieves financial health, incentives such as the proposed performance-based authority will be inadequate to induce improvement.

B. The Commission's Proposal to Combine the Efficiency and Service Performance Authorities is Reasonable

The Public Representative supports the Commission's modification, combining the efficiency and service performance rate authorities. As the Commission notes, the Public Representative previously suggested that the proposed rule should "tie 'the two incentives together by requiring both measures to be met before qualifying for the 1 percent rate allowance[.]" RNOPR at 167, 171 (citing PR Initial Comments at 37). However, the Commission omits the introductory clause to that quoted sentence: "[i]f the Commission can justify these rate allowances for service performance overall" PR Initial Comments at 37. As indicate above, the Public Representative believes that the proposed performance-based authorities have not been justified.

C. The Proposal to Evaluate Efficiency on a Year-to-Year Basis is Flawed

The Public Representative does not support the Commission's shift from a 5-year rolling average to a year-to-year comparison of the TFP indices for evaluating the Postal Service's changes in efficiency. The Public Representative contends that this modification represents a step backwards. As Dr. Bzhilyanskaya previously explained, "Innovations do not necessarily lead to immediate productivity growth, and the economic impact of technological improvements might not be visible for a number of years after making the investments." Bzhilyanskaya Decl. at 8. An approach that relies on the annual changes in TFP does not consider that a longer timeframe is necessary to properly measure the effect of certain types of technological improvements. The proposed reliance on the annual TFP growth encourages the Postal Service to pursue the improvements that can show more immediate impacts in TFP, at the expense of

other capital investments that may be more prudent in the long run. The Commission acknowledges this, stating that “however unlikely, it is possible that the Postal Service could engage in efforts to influence TFP results by not making the best business decisions.” RNOPR at 135. The proposed rule creates a clear incentive for the Postal Service to pursue the investment options that result in more immediate TFP growth to capture additional the rate authority. For longer-term investments, “it is very possible that [they] would result in a lower . . . TFP growth than it could be without these investments.” Bzhilyanskaya Decl. at 8. For these reasons, the Public Representative favors Dr. Bzhilyanskaya’s view that “growth should be measured during a longer period, such as 7-8 years” to mitigate this issue. *Id.*

A year-to-year approach also relies on fewer data points to evaluate TFP changes, which can result in a less reliable analysis. Even the Postal Service’s key consultant on TFP, Christiansen Associates, acknowledges that TFP is susceptible to “substantial year-to-year variations.” Christensen TFP Report at 1. If the Commission intends to rely completely on TFP to assess efficiency changes, it must use the metric in the way that produces the most reliable results.

The Commission appears to acknowledge that a longer timeframe would be more appropriate for TFP, stating that it “recognizes that TFP may not immediately show the impact of short-term operational decisions.” RNOPR at 135. In its initial proposed rule, the Commission recognized that a “rolling 5-year average for TFP growth should allow enough time for the effects of any long-term investments to appear in the TFP calculations.” NOPR at 62. The Commission found that the rolling 5-year average “minimizes the possibility raised by both the Postal Service and Christensen of an isolated annual result being unrepresentative.” *Id.*

Nevertheless, the Commission concludes that “the robustness of the TFP model outweighs this imperfection.” RNOPR at 135 (citing Order No. 4257 at 205). In other words, the Commission has determined that TFP “is currently the best measure of the

Postal Service's efficiency" and, therefore, it "expects the Postal Service to show efficiency gains every year despite these [TFP] limitations." *Id.*

The Commission seems to have picked the timeframe and metric it wants to use to measure efficiency independently of one another. Instead of selecting TFP and then analyzing how it can be used most reliably, the Commission acknowledges that TFP has issues measuring short-term operational changes but opts for a year-to-year timeframe regardless of those issues.

The Commission explains that it decided to revise the timeframe for evaluation due to the "opposing views" of commenters on whether the 5-year time frame was too long or too short. RNOPR at 134. The Commission states that it considered those comments and decided to propose a year-to-year comparison because it "applies a more straightforward approach that allows for a transparent review." *Id.* at 135. Furthermore, the Commission states that the revised approach "allows the Commission to review the Postal Service's operational performance as it changes annually and is not directly influenced by TFP numbers that are more than 5 years old." *Id.* at 134. In summary, the Commission justifies its revised, year-to-year approach on two grounds: (i) as "more straightforward" and thus transparent and (ii) allowing for review of annual efficiency changes.

The Public Representative believes that the provided rationale do not justify the modification to the proposed rule. While a year-to-year approach may be marginally more straightforward, the Commission does not explain why it would be more transparent. Both a 5-year rolling average and the year-to-year approaches will rely on TFP metrics; the only difference will be the timeframe considered. The Public Representative also does not accept the Commission's contention that a year-to-year approach is superior because it grants the Commission visibility into annual operational performance. While a year-to-year approach obviously grants visibility into annual changes, a longer period is necessary to allow more reliable measurement and

incentives for longer-term capital investment. The Commission can easily require annual reporting that will allow for review and visibility while evaluating the efficiency changes on a longer timeframe for the purpose of performance-based authority. The Public Representative concludes that by considering only annual changes in TFP, the Commission accounts for short-term productivity improvements and turns away from measuring efficiency.

D. The Timing of the Performance-Based Authority Will Frustrate its Intent

The Public Representative also contends that the performance-based authority overall will not achieve the Commission's goals because of its timing. Some other commenters have argued that the Commission's approach to performance-based authority is illogical because it gates the capital needed to improve efficiency behind a requirement that the Postal Service improves efficiency. See e.g., APWU Comments at 14-15. The Commission describes this problem as the potential inability for the Postal Service "to achieve efficiency gains without first having the funds to invest in capital" or the so-called "cart before the horse" dilemma. RNOPR at 115

The Commission discounts the position that funds are needed first, stating that these concerns "fail to take into account the other proposed modifications to the ratemaking system[.]" *Id.* at 155-116. The Commission explains that those other modifications are intended to "put the Postal Service on the path to medium-term financial stability." *Id.* at 116. The Commission defines medium-term stability as generating a net income, calculated by subtracting attributable and institutional costs from total revenue. Order 4257 at 165. However, medium-term stability does not allow for immediate capital investment. As the Commission stated "[i]f the Postal Service is stable in the medium-term, any net income accumulated when revenue exceeds costs *will result in retained earnings over time.*" *Id.* at 170 (emphasis added). Put more simply, the other proposed changes aim to allow the Postal Service to generate a modest profit, which it can save up over time as retained earnings, which can then be

used for capital investment, which can then yield the efficiency gains necessary to access the performance-based authority.

In fact, the cart is not before the horse; it's so far behind the horse that it's at the end of a cart tongue a mile long. The Commission's proposed rule should eventually provide retained earnings that the Postal Service can invest, it simply would do so too slowly. As the Commission acknowledges, the Postal Service has experienced a "sharp decline in capital investments" and "now struggles to finance capital investments." RNOPR at 106. In other words, the Postal Service has an immediate, serious need for investment capital that can be used to increase its efficiency. As currently formulated, the proposed rule will not provide that capital until it has years to accumulate, rendering the proposed performance-based authority irrelevant in the short-term. Given the lengthy amount of time required for this process, the Postal Service is unlikely to be able to access this authority to make capital investments before the next system review, 3-5 years from now.

As explained above, the performance-based authority has been constructed to put the Postal Service "on the path to long-term stability" and does not address the Postal Service's immediate, investment capital needs. Order No. 4258 at 53. In this way, the proposed solution does not address the identified problem. Even the Commission's modifications are intended to address "insufficient levels of efficiency gains and cost reductions" without altering the performance-based authority's long-term goals. RNOPR at 13.

If the performance-based authority is claimed in the short-term, it might indicate one of the following scenarios. First, the Postal Service is deferring its other expenses so that it has capital to make long-term investments in the short-term. If the Postal Service has the flexibility to defer other expenses, it would be rational to do so in favor of longer-term capital investments, frustrating the proposed system. This however, may result in lower TFP indices for the next several years. Second, the Postal Service may

be accumulating greater earnings from the proposed supplemental authority than the Commission anticipated. In this situation, the supplemental authority would allow the Postal Service to achieve immediate retained earnings in addition to medium-term financial stability that the supplemental rate authority is designed to achieve.

Regardless, by design, the proposed rule does not provide authority that can be used to generate capital investment funds in the short-term and the Postal Service cannot make capital investments without a scenario that the system does not contemplate, such as those outlined above.

VII. COMMISSION'S PROPOSALS TO ADDRESS NON-COMPENSATORY PRODUCTS AND CLASSES OF MAIL

A. The Commission's Proposal for Non-Compensatory Products in a Compensatory Class Appears Reasonable

The Commission proposes to adopt without substantive change its previous proposal to require minimum product-level price increases for non-compensatory products that are in a compensatory class. RNOPR at 156. Under that proposal, the Postal Service is required to "increase the rates for each non-compensatory product by a minimum of 2 percentage points above the percentage increase for that class." Proposed § 3010.221. This requirement does not create additional rate authority for the class. *Id.* The Commission concedes that this requirement "places some limitation on the Postal Service's pricing flexibility," but "is appropriate because it balances the need for mailers to pay reasonable rates with the need for the Postal Service to achieve cost reductions." RNOPR at 157, 161 (footnote omitted).

The Public Representative supports the Commission's goal of eliminating the losses generated by non-compensatory products. That goal can be achieved through a combination of cost reductions, efficiency improvements, innovations, and price increases. To date, cost reductions, efficiency improvements, and innovations have been inadequate to close the gap between costs and revenues.

On the other hand, price increases for non-compensatory products within the price cap applicable to the class can be achieved only by lowering prices for other products in the class. The Postal Service has asserted that this dilemma restrains it from raising non-compensatory product prices. See Comments of the United States Postal Service, March 21, 2017, at 134-135. By lowering prices for compensatory products in order to be able to raise prices for non-compensatory products in the class threatens to the possible reduction of overall revenues from the class.

In his earlier comments, the Public Representative suggested that the solution to the dilemma confronted by the Postal Service is to raise the price cap for the class and that this would give the Postal Service the opportunity to raise prices for non-compensatory products without having to lower prices for compensatory products in the class. The Commission responded to the Public Representative's comments by stating that in past cases the Postal Service has chosen not to increase prices for non-compensatory products even when it had enough price cap authority to do so. RNOPR at 161.

In this proceeding the Commission's proposed adjustments to the price cap for declines in volume density and exogenous retirement obligations, if properly structured, should give the Postal Service significant additional authority to increase prices for non-compensatory products. The Public Representative would therefore support the Commission's proposal provided the Postal Service is ultimately given enough additional price cap authority by the proposed adjustment for density declines and uncontrollable retirement obligations to raise prices by the amount that the Commission proposes to require. Unless the increase of the cap for the class equals or exceeds the required price increase for the non-competitive product(s), the Postal Service would face the dilemma that it has previously relied upon for not significantly raising non-competitive product prices.

B. The Commission's Proposal for Non-Compensatory Classes Is Inadequate and a One-Time Reset of the Cap Should Be Made

The Commission proposes giving the Postal Service an additional 2 percentage of rate authority for any class of mail with attributable costs that exceed revenue. RNOPR at 174. Unlike its earlier proposal, the Commission now proposes to make the Postal Service's use of the additional pricing authority voluntary. *Id.* at 168.

Although generally applicable to any non-compensatory class, this additional pricing authority has been prompted by the situation presented by the Periodicals class. The Periodicals class has not covered its attributable costs since enactment of the PAEA. FY 2018 ACD at 41. This failure results from the fact that when an entire class is non-compensatory, there is no opportunity to rebalance prices among products, all of which are non-compensatory. In such a case, prices for one product can be increased above the level of inflation only if prices for another product receive increases that are below the level of inflation—a zero sum game. Under this system, the only way cost coverage can be improved is by reducing costs. To date, the Postal Service has failed to realize adequate cost reductions.

The Public Representative continues to believe that “2 percent would do very little to reduce the large negative contribution of Postal Service Periodicals revenue.” PR Comments at 29. Because not all rates for periodicals were compensatory at the time price caps were imposed by the PAEA, the Public Representative continues to support a one-time reset of the price cap that would permit the Postal Service to collect rates as near as possible to estimated total costs. *See id.* at 41. Such a reset is consistent with generally applicable price cap theory and is supported by the declaration of Dr. John Kwoka and Dr. James Wilson, filed with the Public Representative's comments. Kwoka/Wilson Decl. at 15-17.

The Commission has rejected the Public Representative's proposal on the grounds that it “results in 35 to 40 percent in additional authority and immediately

prioritizes adequate revenue (Objective 5) over stability and reasonableness in rates (Objectives 2 and 8).” RNOPR at 171 (footnote omitted). In doing so, the Commission ignored the Public Representative’s assertion that a multi-year phase-in mechanism could be used to moderate the impact of an increase in the cap to cover costs. PR Initial Comments at 61. The Public Representative also emphasized that his proposal did not relieve the Postal Service of its obligation to reduce costs; that the statutory provisions recognize the special place of periodicals in the postal system; that raising the price cap for periodicals would not, by itself, raise prices for periodicals, and that, if periodicals require subsidization because of perceived societal benefits, such subsidies should come from taxpayers, not the Postal Service or other customers. *Id.*

There is nothing inherently wrong with expecting postal products, including periodicals to cover their costs. Price cap theory anticipates the need to adjust price caps when they fail to permit the recovery of costs. *Id.* An increase of the price cap for the Periodicals class should allow for the recovery of costs and can be designed to balance the objectives of increased revenues with price stability and reasonableness. The Commission’s proposal accords too much weight to stability and reasonableness and far too little weight to producing adequate revenue.

VIII. A REVIEW THE MARKET DOMINANT SYSTEM SHOULD COMMENCE IN THREE YEARS

The Commission proposes to review the effectiveness of its proposed regulations in 5 years. RNOPR at 243. Exactly when that 5 year period begins is not expressly stated. See *id.* In discussing the formulas for calculating its Supplemental Rate Authority regulations, the Commission states that the review will be “5 years after implementation....” *Id.* at 94. The date of “implementation” is not specified and could be interpreted either as the effective date of the Commission’s new regulations, the date the Postal Service makes filings to adjust its rates under those regulations, or the date when rate changes go into effect. The latter interpretation would appear to be the most

sensible, since it is only when the Postal Service's proposed rate changes go into effect that the impacts of the Commission's new regulations begin to be experienced. For purposes of the following comments, the Public Representative assumes that the next review period will begin when Postal Service rate changes under the new rules go into effect. To avoid future confusion, the Public Representative would recommend that the Commission clarify when the next review period is deemed to begin.

The Commission offers essentially 6 reasons to support its selection of a 5-year review period. First, the Commission states that it will take one or more rate cycles before data is available to assess, in a comprehensive manner, the changes it is adopting and that 5 years is the optimal review period. RNOPR at 243. Second, the Commission asserts that its approach is "consistent with" its statutory authority to conduct succeeding reviews "as appropriate thereafter." *Id.* Third, the Commission believes that a 5-year review period will balance the competing needs of sufficient time to learn the effects of its proposed rules against the need to protect stakeholders from unintended consequences. *Id.* Fourth, the Commission states, incorrectly, as will be shown below, that the 3-year review period advocated by the Public Representative will only show the effects of two rate cycles. Fifth, that as it continues to monitor the system, the Commission will remain prepared to respond as necessary to changing circumstances, including the enactment of new legislation. *Id.*

On its face, the Commission's defense of a 5-year review period might appear reasonable. However, the Commission has failed to consider the practical implications of its rate proposals for the 5-year period. First, there is at this time no way of knowing when the Commission's final regulations will be issued. In presenting its hypothetical example of how the Supplemental Rate Authority would operate, the Commission states that "[t]he example assumes that the proposed rules take effect prior to December 2020." RNOPR at 99. As discussed in Section V.C.2.a., above, the date that the rules become effective will determine just how soon the Postal Service will be able to

implement new rates. If implementation is delayed until September, 2021, as shown in Table IV-6, the 5-year review period would not end before September, 2026.

While commencement of the Commission's next review in September, 2026, would give the Commission five complete rate cycles of experience, a review that does not begin until September, 2020, would also guarantee over 18 months of the *status quo* (from now until September, 2021) during which time the Postal Service would receive no revenue benefit at all from the proposed regulations. In addition to the 18 month delay and the 5-year review period for gathering data, time will be needed for the Commission to complete the next review and take any necessary further actions. In light of the foregoing, it is reasonable to expect that a "5-year review period" could delay any further necessary changes to the market dominant system for seven years, until mid- to late-2027. This is far too long and could put the Commission in a position in which it has no alternative but "to respond as necessary" to deteriorating circumstances that affect the Postal Service or its stakeholders.

To ensure a more timely review, the Public Representative renews its suggestion in comments on the NOPR for a 3-year review period. Assuming, as above, that implementation of the Commission's new rules does not occur until September, 2021, a 3-year review period would end in September, 2024. This period would provide the Commission with three rate cycles of data (September, 2021-2022, September, 2022-2023, and September, 2023-2024), not the two cycles that the Commission erroneously states would be provided by the Public Representative's proposal. Adding time to complete the review could delay the implementation of any further needed changes until mid- or late- 2025, which is over five years from now. This will give the Commission the opportunity to continue to collect data as it monitors the system. A 3-year review period will clearly give the Commission the data needed to evaluate the new system. It will also provide enhanced protection to stakeholders from unintended or unexpected consequences.

Finally, if the 3-year review period proves to be yielding inadequate data for the next Commission review, the Commission could delay the review. In the Public Representative's view it would be better to extend a 3-year review period to gather more data than to create a risk of having to precipitously truncate a 5-year review period in response to unforeseen circumstances affecting the Postal Service and stakeholders.

IX. CORRECTIONS FOR THE RNOPR TEXT PROPOSED RULES

Correction to section reference in text of RNOPR.

§ 3010.22(b) should be §3010.222(b). RNOPR at 174.

Corrections to proposed rules

Section 3010.182(c) change "§ 3010.182" to "§ 3010.183". Attachment A at 29.

Section 3010.183 change "(c) Calculations" to "(b) Calculations". *Id.* at 31.

Section 3010.183(b)(1) change "§ 3010.184(a)(2)" to "§ 3010.183(a)(2)". *Id.*

Section 3010.184(c)(1) first sentence, change "paragraph (a)(1)" to "paragraph (b)(1)". *Id.* at 33.

Section 3010.184(c)(1) second sentence, change "shall by multiplied together" to "shall be multiplied together" *Id.* at 34.

Section 3010.184(c)(1) third sentence, delete 2d "during the" to read "completed fiscal year". *Id.*

X. CONCLUSION

For the reasons given above, the Public Representative submits that the system for regulating rates and classes for market dominant products should be modified as recommended herein.

Respectfully submitted,

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APPENDIX A

- I. Order No. 3673, Advance Notice of Proposed Rulemaking on the Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products, December 20, 2016 (ANOPR)
 - A. Comments of the Public Representative, March 20, 2017 (PR 2017 Comments)
 - B. Declarations:
 - 1. Declaration of John Kwoka, March 20, 2017 (Kwoka Decl.)
 - 2. Declaration of Timothy J. Brennan for the Public Representative, March 20, 2017 (Brennan Decl.)
 - 3. Declaration of Lyudmila Bzhilyanskaya, March 20, 2017 (Bzhilyanskaya Decl.)
- II. Order No. 4258, Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, December 1, 2017 (NOPR)
 - A. Initial Comments of the Public Representative, March 1, 2018 (PR Initial Comments)
 - B. Declarations:
 - 1. Declaration of John Kwoka and Robert Wilson, March 1, 2018 (Kwoka/Wilson Decl.)
 - 2. Supplemental Declaration of Timothy J. Brennan for the Public Representative, March 1, 2018 (Brennan Supp. Decl.)
 - 3. Supplemental Declaration of Lyudmila Y. Bzhilyanskaya for the Public Representative, March 1, 2018 (Bzhilyanskaya Supp Decl.)
 - C. Reply Comments of the Public Representative, March 30, 2018 (PR Reply Comments)